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CORPORATION FILE

INTERSTATE DEPARTMENT STORES, INC.

1963 ANNUAL REPORT

FOR THE YEAR ENDED JANUARY 31, 1964

DISCOUNT STORES

White Front Stores

CALIFORNIA
- Anaheim
- Canoga Park
- Covina
- East Los Angeles
- Los Angeles
- West Los Angeles
- Oakland
- Pacoima
- * Sacramento
- San Jose
- San Bernardino
- * Sunnyvale
- Torrance
- Van Nuys

Topps Stores

CONNECTICUT
- Berlin
- Fairfield
- Hartford—Windsor
- East Hartford
- Middletown
- West Haven

ILLINOIS
- Chicago—Addison
- Chicago—Arlington Heights
- Chicago—LaGrange
- Chicago—Niles
- Chicago Heights
- Joliet
- Waukegan

INDIANA
- Highland
- Indianapolis—38th Street
- Indianapolis—Speedway

MARYLAND
- Baltimore

MASSACHUSETTS
- Brockton
- Fall River (Kerr Mill Bargain Center)
- West Springfield

MICHIGAN
- Detroit—Oak Park
- Detroit—Redford
- Detroit—Warren
- Kalamazoo
- Lansing

MINNESOTA
- Minneapolis

NEW JERSEY
- Totowa, Rt. 46

NEW YORK
- Albany
- Rochester

OHIO
- Cleveland—Maple Heights
- Cleveland—Mayfield Heights
- Cleveland—Parma Heights
- ** Toledo

PENNSYLVANIA
- Lancaster (Maple Grove Bargain Center)

WISCONSIN
- Green Bay
- Madison

Family Fair Stores

KENTUCKY
- Louisville—Algonquin Plaza
- Louisville—Hikes Point

OHIO
- Canton

PENNSYLVANIA
- Coplay (Discount Fair)

DOWNTOWN DEPARTMENT STORES

ILLINOIS
- Aurora Dry Goods Co., Aurora
- Carroll House, Belleville
- Peoria Dry Goods, Peoria
- Rockford Dry Goods, Rockford
- Springfield Dry Goods Co., Springfield
- Waukegan Dry Goods Co., Waukegan

INDIANA
- The Evansville Store, Evansville
- Stillman's, Fort Wayne
- Hill's, Marion
- Stillman's, Muncie
- Hill's, Vincennes

IOWA
- *** Hill's, Davenport

KENTUCKY
- Jefferson Dry Goods, Louisville
- Paducah Dry Goods Co., Paducah

MICHIGAN
- George W. Toeller Co., Battle Creek
- Stillman's, Jackson
- Carroll House, Port Huron

NEW YORK
- Stanley's, Troy
- Boston Store, Utica

OHIO
- The Boston Store, Springfield

PENNSYLVANIA
- Carroll House, Williamsport
- Stillman's, York

SOUTH CAROLINA
- Bailes, Anderson

TENNESSEE
- The Knox, Knoxville

VERMONT
- Economy Department Store, Rutland

WEST VIRGINIA
- The Huntington Store, Huntington

WISCONSIN
- Fond du Lac Department Store, Fond du Lac
- Hill's Department Store, Sheboygan

SUBURBAN STORES

ILLINOIS
- Rockford Dry Goods, Loves Park

INDIANA
- The Evansville Store, Lawndale
- Stillman's, South Gate

MICHIGAN
- The Fair, Flint

NEW YORK
- Boston Store, Latham
- Boston Store, Massena

* To be opened in Spring 1964
** Opened Spring 1964
*** Closed Spring 1964

INTERSTATE DEPARTMENT STORES, INC.

COMPARATIVE HIGHLIGHTS

	1963	1962
Total sales	$311,153,100	$222,807,300
Net income before taxes	$ 7,122,900	$ 5,249,600
Net income after taxes	$ 3,907,900	$ 2,909,600
Earnings per share	$ 3.08	$ 2.31*
Dividends per share — cash	$ .60	$ .48*
Stock dividends	4%	4%
Working capital	$ 28,298,400	$ 14,786,500
Current ratio	2.1 to 1	1.5 to 1
Stockholders' equity	$ 26,363,400	$ 23,218,900

*Based on the average number of shares outstanding after giving effect to the stock dividend distributed in 1963.

TO OUR STOCKHOLDERS:

Last year was the best in the Company's history in terms of both sales and earnings, and marked the fifth consecutive year in which sales and earnings surpassed any prior year.

Sales rose 40 per cent over last year, setting a new record high of $311,153,000. This compares with $222,807,000 a year ago, and $65,674,000 in 1958, the year before the Company started its expansion program in the self-service retailing field.

Net earnings after taxes amounted to $3,908,000, an increase of 34 per cent over net earnings of $2,910,000 the year before, and approximately six times the $646,000 earned in 1958.

On a share basis, earnings rose to $3.08 from $2.31 a share a year ago, despite an increase in the number of shares outstanding. The average number of shares outstanding amounted to 1,268,025, which compares with 1,217,623 the prior year.

The sharp increase in sales and earnings reflects continuation of the Company's expansion program in the discount field. During the year, seven new discount stores were opened, increasing the number of such stores to 51. The Company also benefited from the full year's operations of the new stores opened the previous year.

Expenses incurred in opening new stores were up over the prior year, reflecting a carry-over of some pre-opening expenses from 1962, as well as the pre-opening expenses of the seven stores added last year. These pre-opening expenses totaled $1,270,000 in 1963, compared with $1,029,000 in 1962.

The carry-over of pre-opening expenses into the current year was sharply lower than a year ago, and this lower level will be maintained through the year.

Improved operating performance enabled the Company to increase its cash dividend and to continue its program of paying stock dividends at the year end. On January 3, 1963, a dividend rate of $.60 annually was established, and on January 8, 1964, this rate was increased to $.70 annually. In addition, a stock dividend of 4 per cent was declared January, 1964, and paid to stockholders the following month. The Company has paid cash dividends in each year since 1940.

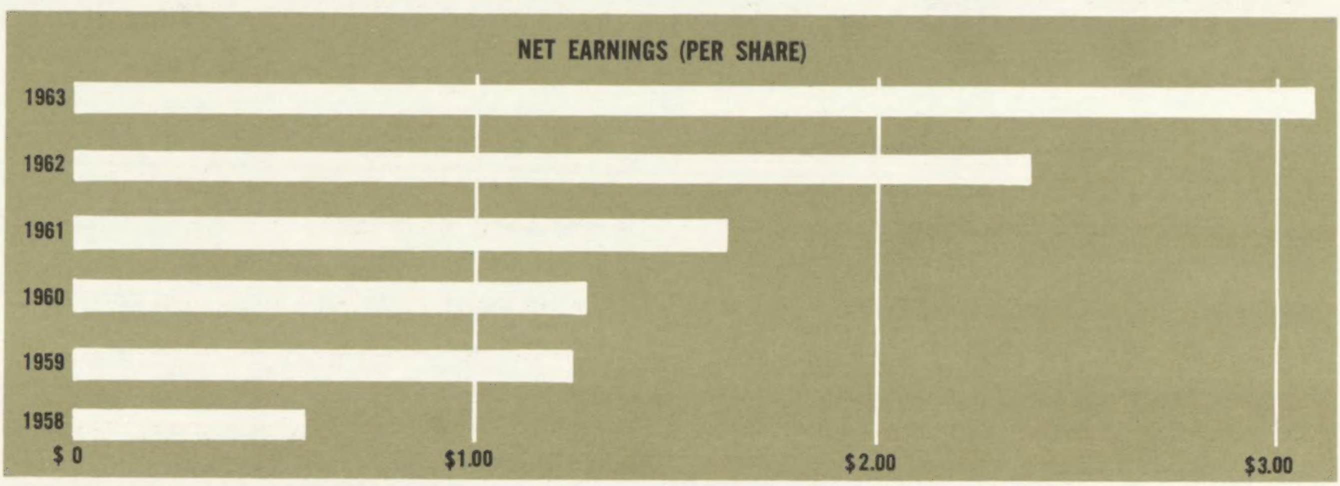
The financial condition of the Company continued to improve. Working capital at the end of the year rose to $28,278,000, an increase of $13,492,000 over the previous year's figure of $14,786,000, of which $10,000,000 was due to completion of a long term loan with a group of insurance companies.

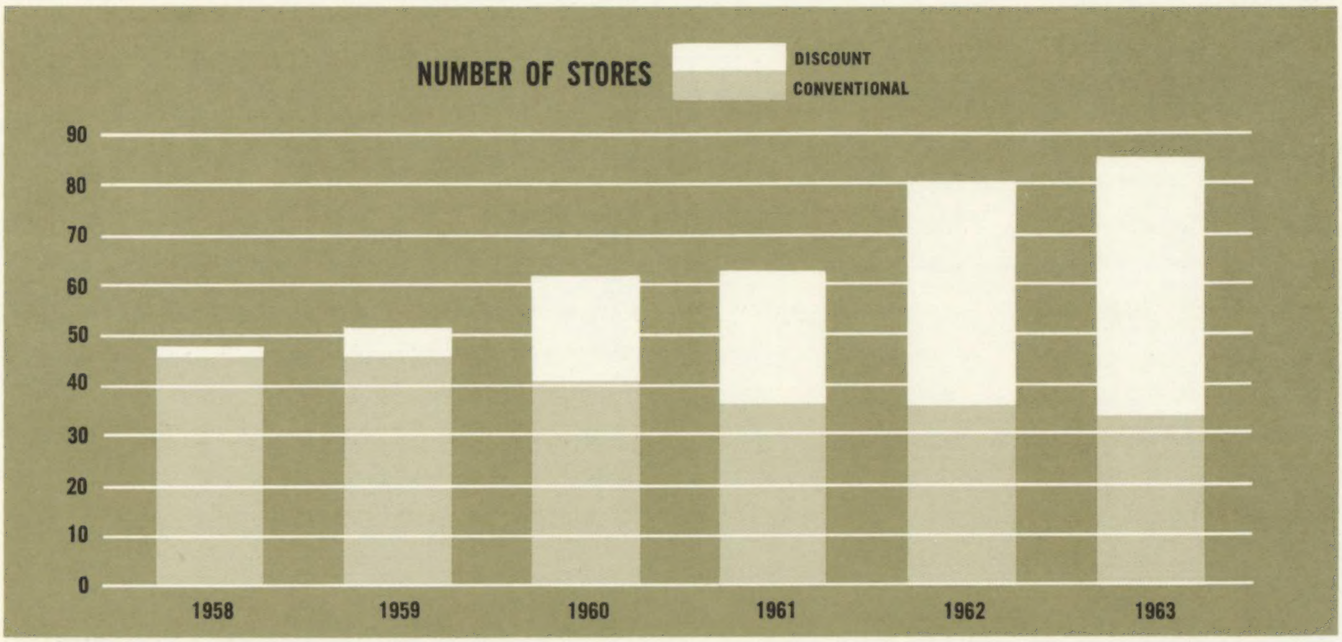
Stockholders' equity increased to $26,363,000 which compares with $23,219,000 a year ago.

In addition to the long term loan of $10,000,000 last year, a public offering of 200,000 shares of common stock was made recently. The funds obtained by the issue will be employed in furthering the Company's expansion program.

Expansion during 1963 was concentrated primarily on the West Coast. Of the seven new units added during the year, five were White Front Stores located in California, at Canoga Park, Oakland, Pacoima, San Jose, and Torrance. The remaining two were Topps Stores, located at Totowa, New Jersey and Rochester, New York.

Though all of the Company's growth has taken place in the field of self-service discount retailing, we have also continued our efforts to strengthen retail operations in the conventional department store field. Expenditures totaling $638,000 were made in modernizing and expanding key downtown stores last year. A major accomplishment was completion of the modernization and expansion program for the Boston Store in Utica, New York. Over a period of two years, approximately $1,500,000 have been invested in this store to strengthen its position as the dominant store in the Utica

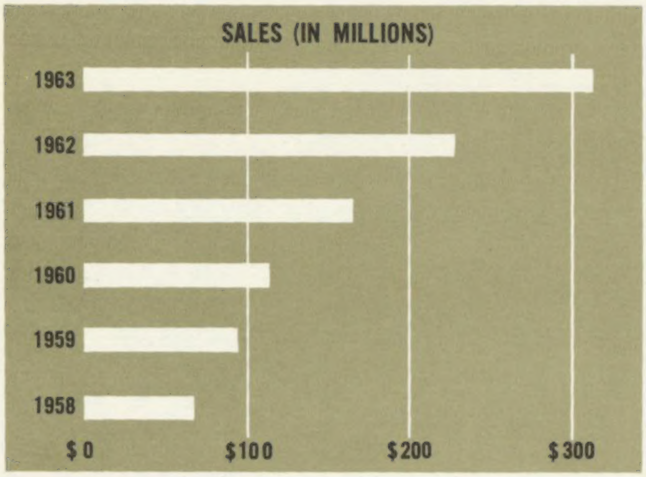




community. It is approximately double the size of the original store, and it now draws trade from areas 50 miles or more from Utica.

The Company's program for strengthening its conventional department store chain also provides for terminating marginal stores when their leases expire. Two such stores were closed last year, reducing the Company's conventional store group to 34 stores at the year end.

We are quite optimistic about the outlook for Interstate. The field of self-service discount retailing is continuing to expand, with certain geographical areas of the country, such as the West Coast, showing particularly rapid rates of growth. We expect to open six new discount centers on the West Coast in the current year and about the same number in that area the following year. We are also planning to expand in other areas of the country as well.



From a long-range point of view, the present rate of growth of the discount industry should continue, and perhaps accelerate in 1965-1966.

Interstate's progress in recent years reflects outstanding performances by many key executives. In recognition of the roles played by the operating managers of the White Front, Topps, and conventional department store divisions, Harry Epstein, Selwyn Lemchen, and Julian Lavitt have been nominated for election to the Board of Directors at the forthcoming annual stockholders meeting.

Another individual who contributed much to the development of Interstate was Charles E. Federman who passed away in October of last year. His presence at Board of Directors meetings will be missed, and his loyal service to the Company will long be remembered.

The board and management also wish to take this opportunity to recognize the tireless efforts of the many individuals, at all levels of organization, who have helped to make the Company's outstanding record possible.

Sincerely,

M. D. Safanie

MURRAY D. SAFANIE,
Chairman

S W Cantor

SOL W. CANTOR,
President

SIX YEAR FINANCIAL REVIEW

	1963	1962	1961	1960	1959	1958
Total sales	$311,153,100	$222,807,300	$165,219,000	$114,311,400	$ 90,316,000	$ 65,674,300
Discount store sales	$256,375,400	$167,481,200	$108,462,200	$ 55,255,500	$ 26,620,900	$ 687,800
Conventional store sales	$ 54,777,700	$ 55,326,100	$ 56,756,800	$ 59,055,900	$ 63,695,100	$ 64,986,500
Net income before taxes	$ 7,122,900	$ 5,249,600	$ 3,829,400	$ 2,385,800	$ 2,309,300	$ 1,005,700
Net income after taxes	$ 3,907,900	$ 2,909,600	$ 2,079,400	$ 1,490,800	$ 1,394,300	$ 645,700
Earnings per share*	$ 3.08	$ 2.31	$ 1.66	$ 1.23	$ 1.20	$ .59
Dividends per share — cash*	$ .60	$ .48	$ .42	$ .36	$ .35	$ .26
Stock dividends (declared)	4%	4%	2%	5%	3%	3%
Stock split	—	—	3 for 1	—	—	—
Working capital	$ 28,278,400	$ 14,786,500	$ 14,904,700	$ 10,661,900	$ 12,798,700	$ 13,626,100
Current ratio	2.1 to 1	1.5 to 1	1.9 to 1	1.7 to 1	2.6 to 1	3.6 to 1
Fixed assets	$ 9,557,100	$ 9,780,600	$ 8,340,300	$ 7,698,700	$ 6,875,800	$ 6,504,700
Long term debt	$ 15,619,200	$ 5,962,700	$ 6,961,000	$ 3,336,800	$ 3,749,200	$ 4,978,200
Stockholders' equity	$ 26,363,400	$ 23,218,900	$ 20,620,600	$ 18,917,800	$ 17,051,300	$ 15,586,300
Stockholders' equity per share*	$ 20.79	$ 18.39	$ 16.57	$ 15.68	$ 14.64	$ 14.05
Number of discount stores	51	44	25	20	5	1
Number of conventional stores	34	36	37	41	46	46

*Based on the average number of shares in each year, adjusted to give effect to all stock dividends distributed through January 31, 1964, and the 3 for 1 stock split distributed June 23, 1961.

PROGRESS REPORT: Five Years of Expansion in the Discount Field

Most new stores are opened with a good deal of fanfare, but that was not the case when in 1957 Interstate started an experimental store in Coplay, Pennsylvania, a suburb of Allentown. The store was given very little publicity outside of the immediate community which it served. The reason was simple: the Coplay store was to be an experimental store where techniques of self-service retailing would be tried and evaluated.

The store proved successful as a pilot operation. Many of the techniques of retailing developed there have been subsequently applied in the management of Interstate's discount stores which totaled 51 at the year-end.

An important step in the Company's expansion in this new area of retailing occurred in the Spring of 1959 when Interstate acquired White Front Stores, Inc., a two-store group in Los Angeles, with annual sales of about $20 million. The next major acquisition was the purchase of the Topps group of 10 discount stores in 1960.

These two acquisitions provided the foundation for building the Interstate organization which is now the largest in number of stores in the discount field. By the end of 1963, the Topps group had grown to 39, located largely in the East and Midwest, and the White Front group, which is concentrated on the West Coast, had expanded to 12 units.

Since the end of the year, a Topps store was opened in Toledo, Ohio, and the number of conventional department stores was reduced to 33 by the closing of a unit in Davenport, Iowa.

Interstate's expansion in the field of discount retailing, which started just five years ago, has had a profound and progressive effect on the Company — on its sales, earnings, financial structure, personnel, and the nature of the business.

Among the highlights of the Company's accomplishments are the following:

Sales: Volume has increased from $65,674,000 in 1958, the year prior to the acquisition of White Front, to $311,153,000 last year.

Earnings: Interstate's net earnings after taxes in 1958 were $646,000, equal to $.59 a share, based on the average number of shares now outstanding, adjusted to give effect to stock dividends and a stock split. Net earnings last year rose to $3,908,000, equal to $3.08 a share on the same average

number of shares. In total dollars, net earnings were better than six times the net of 1958.

Dividends: The Company's dividend program has kept pace with advances in operating performance. In each of the last five years, the Company has declared stock dividends at year end: 3 per cent in 1959, 5 per cent in 1960, 2 per cent in 1961, 4 per cent in 1962 and 4 per cent last year. Interstate also declared a 3 for 1 stock split in 1961.

Four increases in annual cash dividend rates have occurred during this period. The rate in 1959, adjusted for the split in 1961, was $.40 annually. This was increased to $.50 per share in 1961, $.60 a share in January, 1963, and $.70 a share in January, 1964.

DIVIDEND PROGRAM

	Annual Cash Rate*	Stock Dividends	Stock Splits
1963	$ .70	4%	—
1962	.60	4%	—
1961	.50	2%	3 for 1
1960	.50	5%	—
1959	.40	3%	—
1958	.40	3%	—

*Based on the average number of shares now outstanding, adjusted to give effect to stock dividends distributed through January 31, 1964, and the 3 for 1 stock split distributed June 23, 1961.

Financial progress: In the five years through the end of last year, new funds totaling $29,798,000 have been employed in the business. These funds came primarily from the following sources: net earnings supplied $11,782,000; depreciation and amortization allowances, $4,842,000; the issue of 4⅝% Convertible Subordinated Debentures, $5,-859,000; a net increase in long-term debt, $5,478,-000; and stock issued for acquisitions, $1,240,000.

In this period working capital improved from $13,626,000 at the beginning of 1959 to $28,278,-000 at the end of last year. Interstate's investment in fixed assets amounted to $7,894,000, representing fixtures and equipment of its Topps and White Front self-service stores, as well as leasehold improvements made in conventional department stores. A total of $3,043,000 was paid to stockholders in cash dividends.

Character of business: In 1958 the Company's

participation in discount retailing was limited to its experimental store in Coplay, Pennsylvania, and practically all of Interstate's volume of $65,674,000 in that year was derived from its conventional department stores. Last year, conventional stores contributed 18 per cent of total volume, with 82 per cent supplied by discount stores.

Personnel: The Company's organization has grown from about 3,500 employees in 1958 to approximately 7,500 at present. During the pre-Christmas season, the number of employees increases to about 10,000. The Company enjoys harmonious relations with its employees.

The Company is optimistic about the growth pattern of recent years being continued. Self-service retailing has become a major force in retailing because of the better values it can deliver to customers by reason of its built-in efficiencies. The characteristics of this form of retailing — the elimination of unnecessary services, the utilization of self-service retailing techniques, convenient shopping hours, easily accessible locations, and the selection of merchandise to appeal to mass markets — these features have been responsible for the growth of discounting into a $7 billion annual sales industry, and provide the basis for projecting the industry's potential at several times its present size.

Among the favorable developments taking place in the self-service retail industry is the continuing effort by leading companies to improve upon their operations, particular emphasis being given to quality of merchandise and price lines. There is a trend among discounters to become more selective in picking their markets and the merchandise that will appeal to these markets. Constant effort is made by Interstate to test new price lines and to strengthen the appeal of its merchandise lines, without departing from the basic objective of keying merchandise to the vast middle income market.

While Interstate's energies will be directed mainly at expanding its position in the discount field, it also recognizes that there will always be a place in each community for one or more key conventional department stores that have won consumer acceptance and loyalty on the basis of service and fashion. Interstate plans to continue its program of strengthening the role of its major department stores in their respective communities, and to benefit from the profit potential of this form of retailing as well as from discount retailing.

STATEMENT OF SOURCES AND APPLICATION OF FUNDS

FOR FIVE YEAR PERIOD ENDING JANUARY 31, 1964

SOURCES OF FUNDS

Net earnings	$11,782,000
Depreciation and amortization	4,842,100
Stock issued for acquisition of subsidiaries	1,240,000
Proceeds from exercise of stock option	99,800
Debentures issued	5,859,400
Increase in deferred Federal tax	496,100
Increase in long term debt	5,478,400
	$29,797,800

APPLICATION OF FUNDS

Cash dividends	$ 3,043,400
Cost of intangibles applicable to subsidiaries acquired	3,594,200
Fixed assets acquired under modernization and expansion program	7,894,500
Increase in deferred charges	115,000
Other items net	498,500
Increase in working capital	14,652,200
	$29,797,800

CONSOLIDATED STATEMENT OF EARNINGS

	1963 (Year Ended Jan. 31, 1964)	1962 (Year Ended Jan. 31, 1963)
Net sales:		
Owned departments	**$232,931,122**	$173,568,421
Leased departments	**78,221,956**	49,238,899
	311,153,078	222,807,320
Cost of sales (including certain buying, occupancy and distribution expenses)	**259,091,602**	183,611,374
	52,061,476	39,195,946
Selling, general and administrative expenses	**45,614,386**	34,527,916
	6,447,090	4,668,030
Other income—net	**1,484,656**	1,145,131
	7,931,746	5,813,161
Interest expense	**808,825**	563,565
Net earnings before Federal income taxes	**7,122,921**	5,249,596
Provision for Federal income taxes (including $388,000 and $501,000, respectively, of deferred Federal income taxes) (Note D)	**3,215,000**	2,340,000
Net earnings	**$ 3,907,921**	$ 2,909,596

Depreciation and amortization included above amount to $1,123,268 (1963) and $1,025,341 (1962).

See accompanying notes.

CONSOLIDATED

ASSETS

	1963 (As at Jan. 31, 1964)		1962 (As at Jan. 31, 1963)	
Current Assets:				
Cash		$ 4,162,839		$ 2,255,262
United States Treasury Bills—at cost, plus accrued interest		59,672		999,444
Accounts receivable:				
Customers	$ 8,628,737		$ 7,489,491	
Less: Reserves	447,463	8,181,274	391,423	7,098,068
Other		2,953,823		1,751,043
Merchandise inventories (Note B)		36,183,202		30,167,070
Prepaid expenses		1,124,293		1,043,707
Fixed assets held for resale (Note H)		1,500,000		1,314,289
Total Current Assets		54,165,103		44,628,883
Other Assets (Note C)		647,978		427,421
Fixed Assets—at cost (Note C):				
Land, land improvements and buildings	897,326		897,325	
Furniture and equipment	7,996,969		7,975,260	
Leaseholds and leasehold improvements	6,027,667		7,085,485	
	14,921,962		15,958,070	
Less: Reserves for depreciation and amortization	5,364,821	9,557,141	6,177,478	9,780,592
Deferred Charges (including pre-opening expenses of $353,478 and $897,516, respectively)		646,059		1,238,906
Intangibles Applicable to Subsidiaries Acquired (Note A)		3,594,198		3,594,198
		$68,610,479		$59,670,000

See accompanying notes.

BALANCE SHEET

LIABILITIES

	1963 (As at Jan. 31, 1964)	1962 (As at Jan. 31, 1963)
Current Liabilities:		
Notes Payable:		
Banks		$ 7,000,000
Other (Note H)	**$ 1,150,000**	1,150,000
Current installments of long-term debt (Note C)	**76,731**	614,973
Accounts payable—trade	**15,331,192**	14,368,489
Accrued expenses and other liabilities	**4,516,829**	3,206,383
Taxes withheld and accrued, other than Federal income taxes	**1,929,008**	1,667,358
Accrued Federal income taxes (Note D)	**2,882,923**	1,835,195
Total Current Liabilities	**25,886,683**	29,842,398
Deferred Federal Income Taxes (Note D)	**641,072**	646,000
Deferred Compensation Payable (net of applicable estimated Federal income taxes)	**100,000**	
Long-term Debt (Note C)	**15,619,275**	5,962,671
Total Liabilities	**42,247,030**	36,451,069
Stockholders' Equity (Notes C, E, F and I)	**26,363,449**	23,218,931
Lease Commitments and Other Comments (Notes G and I)		
	$68,610,479	$59,670,000

See accompanying notes.

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

	1963 (Year Ended Jan. 31, 1964)	1962 (Year Ended Jan. 31, 1963)
Earnings Retained for Use in the Business as at beginning of year	**$ 13,780,323**	$ 12,829,089
Net earnings	**3,907,921**	2,909,596
	17,688,244	15,738,685
Dividends declared (Note E)	**3,262,682**	1,958,362
Earnings Retained for Use in the Business as at end of year (Note C)	**14,425,562**	13,780,323
Capital Surplus (Notes C, E, F and I)	**9,428,119**	6,984,992
Common Stock (stated at par value of $1 per share, plus $1,271,306 retained as Capital by resolution of the Board of Directors) (Notes C, E, F and I):		
	2,595,245	2,542,886
	26,448,926	23,308,201
Less—Treasury stock—at cost—8,138 and 8,538 shares, respectively	**85,477**	89,270
Stockholders' Equity	**$ 26,363,449**	$ 23,218,931

Shares

	1963	1962
Authorized	**3,000,000**	3,000,000
Issued	**1,274,715**	1,224,271
To be issued	**49,224**	47,309
	1,323,939	1,271,580

See accompanying notes.

NOTES TO FINANCIAL STATEMENTS

The financial statements as at and for the year ended January 31, 1963, are shown for comparative purposes only. Reference should be made to the previously issued report for the Accountants' Report and notes pertaining to those financial statements.

NOTE A—In the opinion of management no amortization of intangibles is required, since to date there has been no indication of a loss or a limitation on the useful lives of such intangibles.

NOTE B—Merchandise inventories are stated at the lower of cost or market based principally, as to inventories at stores ($28,684,686), upon the retail method; the cost of approximately 10% of the inventories is determined by the last-in, first-out method.

NOTE C—Long-term debt consists of the following:

	Total	*Portion Payable Within One Year*	*Portion Payable After One Year*
5⅝% Notes payable — insurance companies	$10,000,000		$10,000,000
4⅝% Convertible Subordinated Debentures due August 1, 1981	5,162,700		5,162,700
Collateral note, payable in three installments of $35,750 to November 29, 1965, without interest	107,251	$35,750	71,501
6% Note payable to bank, due in monthly installments (including interest) of $2,221 to February 1, 1971	153,444	17,929	135,515
Mortgages and trust-deed notes payable	272,611	23,052	249,559
	$15,696,006	$76,731	$15,619,275

In August 1963, the Company borrowed $10,000,000 from certain insurance companies under a Note Agreement and used the proceeds to pay off a like amount owing to banks. This loan is payable $500,000 a year (on January 15) from 1967 to 1976, inclusive, and $600,000 a year (on January 15) from 1977 to 1983, inclusive. The unpaid balance is due July 15, 1983. The loan may be prepaid, in whole or in part, at principal amount plus, under certain conditions, a premium of 5.375%, which premium declines annually by specified amounts.

The indenture under which the 4⅝% Convertible Subordinated Debentures due August 1, 1981, were issued requires that the Company pay into a sinking fund, during the years 1968 to 1980, an amount sufficient to redeem each year $275,000 principal amount of Debentures. The Company may, at its option, pay into such sinking fund an additional amount not to exceed $275,000 in any year. In addition, the Debentures may be redeemed, in whole or in part, at principal amount plus a premium of 4.125%, which premium declines ¼ of 1% annually.

The Debentures may be converted into Common Stock at a conversion price of $26.37 a share, as adjusted for stock dividends. During the year, $81,500 of Debentures were converted into 2,967 shares of Common Stock, resulting in increases in Common Stock of $2,967 and in Capital Surplus of $75,587 (net of related unamortized debt discount and expense). Based upon the foregoing conversion price, the outstanding Debentures at January 31, 1964, may be converted into a maximum number of 195,779 shares of Common Stock.

The indenture relating to the Debentures and the loan agreement with the insurance companies contain, among other matters, covenants restricting the right of the Company to declare dividends (other than stock dividends). Under the most restrictive of these covenants, approximately $4,500,000 of consolidated surplus and earnings retained for use in the business is not restricted for the payment of dividends (other than stock dividends) as at January 31, 1964.

The collateral note payable represents the balance due for the purchase of a one-sixth interest in a company; the related capital stock of such company is being held by the seller until the note has been paid in full. The amount of the investment ($143,002) is included in the caption "Other Assets" in the accompanying consolidated balance sheet.

The mortgages and trust-deed notes payable set forth above are collateralized by fixed assets having an aggregate depreciated cost of approximately $480,000 as at January 31, 1964. They are payable in varying installments to 1975, with interest at the annual rates of 4½% (mortgages) and 6% (trust-deed notes).

NOTE D—The Treasury Department is currently examining the tax returns of White Front Stores, Inc. (a wholly-owned subsidiary), the Company, and its other subsidiaries for the years ended January 31, 1960 and 1961. The agent examining the White Front returns has reported that he proposes to disallow all New York office expenses that were allocated to that subsidiary. The other examining agents have proposed a re-allocation of New York office expenses among the other store subsidiaries on a basis different from that used by the Company for several prior years and accepted for such years by the Treasury Department. In the opinion of the Company, these proposed adjustments are improper, but should the additional taxes be assessed on the bases currently being suggested by the Treasury Department, the provision for Federal taxes on income for the years ended January 31, 1960, 1961, 1962, 1963 and 1964 would be increased by approximately $114,000, $114,000, $86,000, $184,000 and $147,000, respectively, exclusive of interest. No provision for additional Federal income taxes has been made for the foregoing with respect to the years under tax examination and subsequent years. The ultimate disposition of such matters cannot presently be predicted; however, the Company is of the opinion that such disposition should have no material effect upon the accompanying financial statements.

The examining agents have also proposed other adjustments, the effect of which, if assessments are made on the basis of such proposed adjustments, would be increases of approximately $115,000 and $105,000 (exclusive of interest) in the provisions for Federal income taxes for the years ended January 31, 1960 and 1961, respectively. In the Company's opinion, these proposed adjustments are without merit and will not result in additional tax assessments for those years or subsequent years.

The investment credits available under the Revenue Act of 1962 have been applied to reduce, by approximately $163,000, the provision for income taxes; such reduction includes approximately $45,000 carried forward from the preceding year. For such preceding fiscal year, available credits aggregated approximately $44,000 and a provision was made in that year for deferred taxes equivalent to 52% thereof, the remaining 48% thereof (approximately $21,000) being applied as a reduction of the provision for income taxes for that year.

The provision for Federal income taxes has also been reduced by approximately $139,000, resulting from the utilization of operating loss carryovers and carrybacks.

The accompanying financial statements are subject to final determination of Federal, state and local taxes.

NOTE E—Dividends declared, as shown in the accompanying consolidated statement of stockholders' equity, consist of cash dividends of $790,325 and, based upon market quotation, a four percent stock dividend of $2,472,357, of which $70,226 is payable in cash in lieu of fractional shares. The aggregate par value ($49,224) of the shares issuable in connection with such stock dividend has been credited to Common Stock and the balance ($2,352,907) has been credited to Capital Surplus.

NOTE F—Under the Company's restricted stock option plan, options may be granted to officers and key employees to purchase not more than 88,083 shares of the Company's Common Stock at not less than 95% of fair market value at date of grant. The options are exercisable 20% a year (on a cumulative basis) commencing one year from date of grant and expire ten years from date of grant. During the year, options (1) were granted for 6,968 shares, (2) lapsed for 10,738 shares and (3) were exercised for 168 shares resulting in credits to Common Stock ($168) and Capital Surplus ($5,127). As at January 31, 1964, options were outstanding for the purchase of 75,077 shares at prices ranging from $30.31 to $38.42 a share. The number of shares and prices per share have been adjusted for the effect of stock dividends.

NOTE G—At January 31, 1964, the minimum annual rentals of real and personal property leased to the Company or to its subsidiaries under leases expiring after January 31, 1967, and applicable to stores in operation as at January 31, 1964, amount to approximately $7,350,000 plus, in certain instances, additional rentals based upon sales and charges for real estate taxes, insurance, etc. In addition, for stores scheduled to open subsequent to January 31, 1964, (for one of which a lease had been executed as at that date), minimum annual rentals are estimated to approximate $460,000 and will commence upon opening of the stores.

Included in the minimum annual rentals above is approximately $180,000 representing rentals applicable to fixed assets sold substantially at depreciated cost and leased back during the year.

NOTE H—Fixed assets held for resale represent the accumulated costs of a store building under construction. The Company has received a commitment under which it will sell such building (when completed) and lease it back for a period of approximately 40 years. In the opinion of management the total construction costs of the building should be approximately equal to the proceeds of the aforementioned commitment. The Company is required to apply the proceeds of such sale to the repayment of amounts then due under a note payable; as at January 31, 1964, indebtedness under such note amounted to $1,150,000.

NOTE I—The Company has filed a Registration Statement with the Securities and Exchange Commission covering the proposed sale of 200,000 shares of Common Stock.

In the opinion of management, pending litigation will not materially affect the accompanying consolidated financial statements.

At January 31, 1964, the Company is contingently liable for $1,325,000 under an accommodation note (due December 1, 1988) that it issued in connection with one of the sale-leasebacks during the year (see Note G). This contingent liability is subject to reduction to the extent that the lessor makes required payments against a note issued by it in the same principal amount.

Capital Surplus has been credited with $9,506, arising from the issuance of 400 shares of Treasury Stock as a bonus to an employee.

ACCOUNTANTS' REPORT

To the Board of Directors
Interstate Department Stores, Inc.
New York, N. Y.

We have examined the consolidated balance sheet of Interstate Department Stores, Inc., and subsidiary companies as at January 31, 1964, and the related consolidated statements of earnings and stockholders' equity for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We have previously examined and reported on the prior year's financial statements. Due to the tax matters commented on in the first two paragraphs of Note D, our previous opinion is now subject to the outcome of such tax matters.

In our opinion, subject to the outcome of the tax matters referred to in the first two paragraphs of Note D, the accompanying consolidated balance sheet and consolidated statements of earnings and stockholders' equity, together with the notes to financial statements, present fairly the consolidated financial position of Interstate Department Stores, Inc., and subsidiary companies at January 31, 1964, and the consolidated results of their operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

S. D. Leidesdorf & Co.
Certified Public Accountants

New York, N. Y.
March 26, 1964

INTERSTATE DEPARTMENT STORES, INC.

EXECUTIVE AND GENERAL OFFICES:
111 Eighth Avenue, New York, N. Y.

DIRECTORS:

Sam J. Abend
Sol W. Cantor
Barry Golden
Emanuel P. Lewis
M. Lester Mendell
Albert Parker
Paul D. Preger
Murray D. Safanie
George H. Stuntz
Harold J. Szold

OFFICERS:

Murray D. Safanie
Chairman of the Board

Sol W. Cantor
President

Sam J. Abend
Vice President

Barry Golden
Vice President

George H. Stuntz
Treasurer

Albert Parker
Secretary

Edward C. Schenkel
Assistant Treasurer and Assistant Secretary

TRANSFER AGENT:
The Chase Manhattan Bank, N. Y.

REGISTRAR:
Manufacturers Hanover Trust Co., N. Y.

GENERAL COUNSEL:
Parker, Chapin and Flattau, N. Y.

PUBLIC ACCOUNTANTS:
S. D. Leidesdorf & Co., N. Y.

SHARES LISTED:
New York Stock Exchange

ANNUAL MEETING:
Fourth Wednesday in May